



Early Journal Content on JSTOR, Free to Anyone in the World

This article is one of nearly 500,000 scholarly works digitized and made freely available to everyone in the world by JSTOR.

Known as the Early Journal Content, this set of works include research articles, news, letters, and other writings published in more than 200 of the oldest leading academic journals. The works date from the mid-seventeenth to the early twentieth centuries.

We encourage people to read and share the Early Journal Content openly and to tell others that this resource exists. People may post this content online or redistribute in any way for non-commercial purposes.

Read more about Early Journal Content at <http://about.jstor.org/participate-jstor/individuals/early-journal-content>.

JSTOR is a digital library of academic journals, books, and primary source objects. JSTOR helps people discover, use, and build upon a wide range of content through a powerful research and teaching platform, and preserves this content for future generations. JSTOR is part of ITHAKA, a not-for-profit organization that also includes Ithaka S+R and Portico. For more information about JSTOR, please contact support@jstor.org.

RELATION OF VALUATION TO INVESTMENTS

THOMAS W. HULME

Vice-Chairman of the President's Committee on Federal Valuation

I SUPPOSE the greatest act of discourtesy would be to deny the introduction of the host, and yet it is farthest from my purpose to talk upon fair value. There isn't any such thing as fair value. It is just value. It is because there has been so much talk of fair value in rate cases that we have all this confusion upon the subject today.

It is not my intention either to go into the many phases of the valuation problem, but rather it is my desire to suggest to investors that they should not accept what has been given out as valuations by various state commissions as representing the true value of their property. Nor should they take these reports that are being given out by the Interstate Commerce Commission, as representing value, because they are not even an attempt upon the part of the Commission to determine value. They are merely inventories or reports covering the investigations made by the engineering, land and accounting sections of the Commission of things that are to be taken into consideration in determining value.

To come directly to the subject which I have chosen to speak to you upon, the "relation of valuation to investments," we should have a common understanding of the terms "valuation" and "investment." The present investment is not necessarily what was originally put into the property. The corporate ownership may have changed hands upon a different basis; some portions of the physical property may have increased in value and some may have decreased in value. The Supreme Court of the United States has said that it is the property and not the original cost of it that is protected by the Constitution, and of which property the owner may not be deprived without due process of law. Therefore, as it is the property that is the investment, it means the investment is measured by the present value.

The determination of the value of property, i.e., of privately owned property, not in public use is ordinarily measured by what it would bring in exchange, usually determined by its earnings past, present, and prospective. But that cannot be the same when you come to deal with private property that is subject to

public use, because there regulation immediately enters and, to a certain extent, determines the result.

Now regulation cannot go to the extent of destroying the value of the property, nor can the owners of the property make such unreasonably high charges as to increase the value thereof. The problem, therefore, is how is this situation to be met? Where rates themselves are in question, the value cannot be determined by the capitalization of the net.

This problem, in the twenty-five years that it has been under consideration, has many times been before commissions and courts. Almost always, as the chairman stated, they have dodged the real determination. They have approached it from the standpoint of what seemed to them fair, but as the Constitution stands in the way of taking any portion of the property, without due process of law, they have called their conclusions, value. These conclusions, reached by many different commissions, without the determination of correct principles by the courts, because, as the chairman says—and I do agree with him sometimes—they have not been definite or have not been reached with courage, have left the matter in an uncertain condition until, perhaps, the present time when it seems to be clarified.

The court has said that the value of such property should be determined by the exercise of a reasonable judgment in the consideration of all the pertinent facts, including the actual investment if known, the present cost of production of the property, its condition, its earnings, both at the present time and under contemplated rates, and all other pertinent facts.

When these decisions have been made, it has not usually been known to which of these factors the commission has given the greatest weight, but it has been quite clearly shown that, while in the few condemnation cases, that is, the taking of the ownership of a public utility, it was not only the physical property that had to be paid for, but it was also the value of the business, the enjoyment of the business, that had to be paid for. Nevertheless, there has been generally a tendency to deny in a rate proceeding that the business had to be taken into consideration, but, in a decision by the Supreme Court of the United States in June of this year (the Denver Water Company case) it seems to be clearly decided that, even in a rate proceeding, consideration must be given not only to the bare bones of the property, but also to the business of the utility. That seems to be in accordance with com-

mon sense, because I think it is generally recognized that property is worth very much more after it has developed a business than it would be when it was first finished.

We, therefore, have, as I understand it, in the valuation of property privately owned but used for a public purpose, two major elements for consideration. First, the valuation of the physical property, next the valuation of the business, ordinarily referred to as "going concern" value; in the case of a private business not subject to Governmental regulation, it is commonly referred to as "good-will," although the term "going concern" embraces very much more than good-will. A local monopoly, such as water, gas or electric property, perhaps, cannot be said to have good-will, but a railroad where the business has been built up under competitive conditions, as most of these railroads have been, many of them, enjoy good-will, so that in some cases the good-will would be present; in other cases it would not.

Our first consideration, therefore, is the determination of the value of the physical property. Unquestionably the courts have held, in many cases, that the cost of reproduction properly applied is the measure of the value of the physical property. In the case of any normal property, i.e., one whose existence is justified, it certainly must be held that it is worth its cost of reproduction under a proper method. It is conceded that there may be cases of railroads and other utilities that have been constructed where they are not needed, and I except that class of property to my contention. But great care must be taken in such a classification of any property lest injustice be done.

Now, I am not saying that the cost of reproduction must necessarily be at present-day prices, but I am saying it must be upon reasonable conditions that would be generally acceded to as being reflective of a general situation; if, however, any governmental authority should attempt at this time, when we have probably reached a permanent level of higher prices, to take the property of such a company, there is no doubt in my mind but that in a condemnation proceeding the court would hold that the trend of prices has been so unmistakably to a higher level that the present-day prices would apply.

Therefore, I say to investors that the weight of the decisions of our courts are so unmistakably in the direction of a protection to them in a valuation proceeding that they should not be misled by proceedings in the past which have been made solely from the

standpoint of what somebody thought was "fair" to determine in a rate case.

What has been the effect of such valuations, such "fair" valuations? The unmistakable result has been to reduce the net earnings, to impair the credit until we have reached the present stage. Now, if the credit is to be restored, as Mr. Oldham and other speakers have said, it must be through an authority to increase the charges to a point where they will not only yield a return on the present investment, but also yield a return on the amount of money that it is necessary to provide for extensions and additions and betterments.

So frequently governmental bodies overlook that point in establishing their rate basis. They try to fix it on what has been sufficient for the past, overlooking the fact that provision must also be made for the new capital that is going into the property. If we have in the case of a justified property that the valuation of its physical property should be its cost of reproduction, provided that property has been properly maintained for the purpose for which it has been used, we then have to consider what effect in reaching the total or true value of that property must be given to its earning power. Earning power means potential, future developments and not merely the present basis of earnings.

There are many properties that are unquestionably worth more than their mere physical value. Where, over a considerable period of years, those properties have yielded a return upon the investment that is more than the usual interest rate, it must be recognized that those properties, because they have an earning capacity greater than the ordinary, must be accorded a value greater than their physical value. In such cases, where the rates under which their earnings are obtained are not in question, the value of the properties would be what you are accustomed to think them to be, the economic value.

Without any attempt to make a contention that there must be a minimum value, it must also be apparent that any road that is doing a great volume of business, even though in the past under regulation which has really been in an embryonic state—regulators have to learn just as great business organizations have to be developed—that, when this investigation is completed by the Interstate Commerce Commission, they will have at hand the information that will, I think, give the answer to what is called the present railroad problem.

This work of the Commission is probably the greatest economic task ever undertaken. It has been under way now for a little more than six years. It has cost over sixty millions of dollars. The mere inventory work will, according to the director in charge, be completed by the end of 1921. The Commission has refrained from attempting to determine the principles of valuation of this class of property until its work can be further advanced and until the Commission shall have before it some of the representative types of property. It has scheduled a hearing in January next for argument upon the subject. At that time, there will be presented to it the views that I have just expressed to you and which, if they should be successful before the Commission, will, I am sure, be a full measure of protection to your investments.